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Pressure Rises on Tax-Trading Strategies

Detailed Trading Records Requested From Bank of America's London Unit



A request for detailed trading records from Bank of America's London unit came in a letter from Globe Tax Services.

PHOTO: BLOOMBERG NEWS

By [Jenny Strasburg](#)

Jan. 14, 2015 6:22 am ET

LONDON—Fallout from government investigations into controversial trades used by investors and banks to reduce taxes is mounting, with a London hedge fund recently closing and [Bank of America](#) Corp.'s [BAC 1.88% ▲](#) European investment-banking unit being pushed for information about the trades.

The request for detailed trading records from Bank of America's London-based Merrill Lynch International unit came in a Dec. 19 letter from Globe Tax Services Inc., a New York-based company that processes tax-refund paperwork for banks and investment firms. A copy of the letter, reviewed by The Wall Street Journal, was sent at the request of German tax authorities, according to a person familiar

with the matter.

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EQI Asset Management LLP, a small London hedge fund that was once a prominent practitioner of a trading strategy known as dividend arbitrage, shut down in October amid enquiries by the British and German tax authorities, according to people close to the firm.

Salim Mohamed, EQI's founder and a former Merrill Lynch managing director, didn't respond to requests for comment by email and through business associates.

The investigations are focused on a type of dividend-arbitrage strategy known as "cum/ex," the Journal has previously reported. Investment firms used cum/ex trades to claim rebates on withholding-tax payments despite not having actually paid such taxes in the first place, according to people familiar with the trades and internal bank and hedge-fund documents reviewed by the Journal.

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The investigations are focused on how asset-management firms, banks and brokerages made trades that authorities say profited by improperly exploiting European tax loopholes. The probes are targeting an expanding pool of financial institutions, according to people familiar with the enquiries.

London-based units of global banks including Banco Santander SA, Bank of Nova Scotia, Macquarie Group Ltd. and Nomura Holdings Inc. have received enquiries from the U.K.'s H.M. Revenue & Customs agency, the people say. Bank of America hired an outside law firm to review the bank's involvement in cum/ex trades, according to people familiar with the matter. A senior equities-finance trader has told business associates in London that areas of focus include financing the bank provided to hedge funds that placed big trades on German stocks, according to people familiar with the matter.

Banks in some cases executed cum/ex trades themselves, according to industry officials and trading documents. In other cases, they lent money or stocks to clients to facilitate the trades, with London trading desks and brokerage firms playing a central role.

A spokesman for the U.K.'s Revenue & Customs agency said the agency gathers "foreseeably relevant" information to share with tax-treaty partners but wouldn't discuss individual companies or confidential information exchanged.

In another sign of intensifying scrutiny, the letter from Globe Tax requests detailed trading documents from Bank of America's London-based unit by Feb. 9.

The letter was sent at the request of Germany's Federal Central Tax Office and cites Germany's determination that it was "systematically harmed" through trades "in which capital gains taxes were returned in accordance with refund applications, even though no tax withholding took place for the underlying

income."

The letter adds that German tax authorities believe "considerable tax evasion occurred" in 2010, noting a continuing "investigatory process."

A Bank of America spokesman declined to comment. Len Lipton, a Globe Tax managing director, said he couldn't discuss specific audit requests, but that his firm is an intermediary between international tax agencies and financial firms. "When we receive the information, we forward it to the appropriate authority."

Another investment firm under scrutiny is ZFP Equity Ltd., which has principals in London and Dubai. ZFP is cooperating with the enquiries, said Grenville Solomon, a London-based ZFP director who previously worked at Macquarie and Morgan Stanley. "We've been asked questions, like others have. It's an open investigation," he said.

Mr. Solomon declined to discuss specifics of ZFP's trades, but said the cum/ex market had many participants. "If someone was looking to buy something, we placed the order," he said. Like other firms, ZFP has scaled back its dividend-arbitrage trading.

EQI, which Mr. Mohamed started in 2009 and had just a handful of employees, dismissed senior employees last year and vacated its offices in London's Mayfair district in October, according to the people close to the firm. EQI has applied to cancel its authorization to operate as a regulated U.K. investment entity, according to a public filing.

Dividend-arbitrage trades in general are designed to place ownership of shares in lower-tax-rate countries for the purpose of minimizing dividend taxes upfront or generating repayment claims. Most of the trades are considered legal. They generate more than \$1 billion in annual revenue for banks, the Journal reported last year.

Still, such trades have become controversial among regulators such as the U.S. Federal Reserve, which the Journal reported has expressed concerns about potential legal and reputational harm. German prosecutors have said the cum/ex subset of dividend-arbitrage strategies were illegal.

Tax-law changes started making the trades more difficult in 2010. Before that, some small firms made hundreds of millions of dollars from the strategy, industry officials said.

The complex trades often relied on a practice known as “looping,” in which shares were shuttled among multiple parties around the time of scheduled dividend payments. The goal was to collect tax refunds or credits in excess of what the investment firms were actually entitled to.

Banks routinely extended close to \$1 billion in financing to individual firms to amplify cum/ex trades, according to industry officials and fund documents.

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